APPENDIX H - FUNDING AND FINANCING OPTIONS

The City has limited funds for capital improvements to the water, sewer, and storm drainage systems. This section briefly discusses funding and financing. The term "funding" refers to the method of collecting funds; the term "financing" refers to methods of addressing cash flow needs.

Funding For Improvements Benefiting Existing Development

Fees and/or taxes are necessary to pay for improvements regardless of whether the improvements are funded directly from the fees (as with pay-as-you-go financing) or funded up front (as with debt financing).

Benefit Assessments/Utility Fees. Benefit assessments or utility fees, sometimes called service fees or user fees, consist of a fee imposed on each property in proportion to the service provided to that property. Benefit assessments or utility fees are generally used as a means of funding water and wastewater services, but they are also becoming increasingly common as a source of funds for stormwater management.

They are inherently flexible in that the agency can select any assessment method that equitably relates the amount charged to the service provided. Benefit assessments are usually included as a separate line item on the annual property tax bill sent to each property owner. Utility fees are usually billed on a monthly or bi-monthly interval. In other respects, benefit assessments, utility fees and service charges are essentially identical. The City has the authority to collect a benefit assessment, but only after approval by a majority of the voters, affected property owners, or rate payers.

General Funds. General fund money comes largely from property taxes and sales taxes. Usually, the demand for funds by all City departments exceeds the supply available. It is thus unlikely that the City's general funds would be sufficient for the increased demand for utility facilities.

Sales Tax. The primary advantage of the sales tax, as a source of revenue, is its broad taxing base. The allocation of sales tax increases to finance the drainage program would raise significant revenues. Voter acceptance and approval of such a tax increase could be expected to require significant public relations and community involvement efforts to be successful. Sales tax increases have been approved in the past by voters in the Bay Area and southern California, but the revenues were raised for transportation improvements. It is uncertain weather a sales tax increase for storm water management would receive voter approval.

Gas Taxes. Where storm water management problems related to bridges and culverts, it is common to fund some or all of the construction and maintenance costs of the bridges and culverts from gas taxes. Some drawbacks to this source of funding are:

- Gas taxes can only be used for items that relate to roads, such as bridges and culverts.

- Entities setting the spending priorities for gas tax funds do not generally have storm water management as a high priority in their spending decisions. High priority projects from a storm water management point of view may have a low priority from a transportation point of view and hence will be delayed or never constructed.

Funding for Improvements Benefiting New Development

In addition to the public funding options, it may be possible to require developers to finance improvements for new development. Some of the funding options available are discussed below.

Development Charges/Connection Fees. The system development charges represent the cost of providing regional conveyance and treatment facilities to serve the new development area. They are one-time fees charged to developers at the time of subdivision approval or building permit issuance. The charges for individual properties may be based on whatever assessment measures the agency desires for equity.

The development fee is generally applied on a unit cost basis with the acre used as the most common unit. Other units based water consumption for water, sewer flows for sewer, and land uses and impervious surfaces for storm drainage can be used. The fees may vary between pressure zones (water), sewer service area (sewer), and subbasin (storm drainage).

A disadvantage to utilizing development charges is that they cannot be used to fund the correction of existing problems in already developed areas. Another difficulty with impact fees is that the fees cannot be collected until the building permit stage at the earliest. The amount collected each year depends solely on the rate of development. Consequently, funds may not be available to construct new capacity at the time it is needed.

Developer-Provided Infrastructure. For developing areas with specific water, sewer, or storm drainage system needs, each developer may be required to construct the regional infrastructure needed to accommodate the development of their lands. This approach is typical for improvements within the development project boundaries, but it could be extended to off-site improvements also. When a developer constructs regional facilities, a development fee is frequently charged to other developments within the service area and the first developer is reimbursed.

Advantages of this method are that it is politically easy to implement and that only users benefiting from the improvements need to pay for them. The disadvantage is that the first developer in an undeveloped area must finance the costs of regional improvements, making the approach inequitable.

Mello-Roos Community Facilities District. The Mello-Roos Community Facilities Act was enacted by the California Legislature to provide an alternative method of funding and financing certain essential public facilities and services. It is directed especially to developing areas and areas undergoing rehabilitation.

Regarding facilities, the Community Facilities District may finance the purchase, construction, expansion, or rehabilitation of any real or other tangible property with an estimated useful life of five years or longer.

There is considerably more flexibility in the method of determining special taxes for a Mello-Roos District than under the assessment acts. Each property is allocated its responsibility for debt service according to a "special tax" formula (which must not be ad valorem). The formula may allow shifts in financial burden among the properties as they are split and developed according to various land uses. Existing and future development and inflation of costs may be considered in developing the method of determining taxes. Mello-Roos Districts are primarily intended to fund capital costs, but provisions in the legislation permit Mello-Roos Districts to fund certain ongoing costs including operations and maintenance of storm water management facilities.

The greatest hindrance to community facilities district formation is the approval required by two-thirds of the registered voters or property owners. It is utilized best in developing areas in which there are still a minimal number of landowners.

Financing for Improvements Benefiting Existing Development

Debt financing is necessary if pay-as-you-go financing would not produce sufficient revenue within the needed time frame. Pay-as-you-go financing may be undesirable because it creates cash flow problems for public agencies and can be inequitable. Taxes and user fees, as described previously, are then used to repay the debt. Debt financing is only possible if a reliable source of funds is available to make regular debt payments.

Pay-As-You-Go Financing. Pay-As-You-Go financing involves periodic collection of capital charges or assessments from customers within the municipality's jurisdiction for the purpose of funding future capital improvements. These revenues are accumulated in a capital reserve fund and are used for capital projects in future years. Pay-as-you-go financing can be used to finance 100 percent or only a portion of a given project. One of the primary advantages of pay-as-you-go financing is that it avoids the transaction costs (e.g., legal fees, underwriters' discounts, etc.) associated with debt financing alternatives such as revenue bonds.

There are two common disadvantages associated with this method. First, it is difficult to raise the required capital within the allowable time period without charging existing users elevated rates. Second, it may result in inequities in that existing residents would be paying for facilities that would be utilized by, and benefit, future residents.

State Revolving Fund. The federal Clean Water Act provides for the creation of a State Revolving Fund Loan Program, capitalized in part by federal funds. The Division of Loans and Grants at the State Water Resources Control Board oversees this program which provides loans for funding construction of publicly owned wastewater treatment works and for implementation of non-point source pollution control management programs. The final policy on eligible storm water projects has not been developed.

Loans may be available at one-half of the interest rate that the State paid on the most recent sale of general obligation bonds. The amount of the loan will be determined by the eligible capacity that is determined by considering appropriate peak flows. Costs incurred for future capacity needs for a certain number of years are allowed; the wastewater program allows for flow projections up to 40 years. Disadvantages of this method of funding include the competitiveness and length of the process.

Revenue Bonds. Revenue bonds are historically the principal method of incurring long-term debt. This method of debt obligation requires specific non-tax revenues pledged to guarantee repayment. Because non-tax revenues, such as user charges, facility income, and other funds are the bond holder's sole source of repayment, revenue bonds are not considered general obligations of the issuer. Revenue bonds are secured solely by a pledge of revenues. Usually the agency's revenues are derived from the facility that the bonds are used to acquire, construct, or improve. There is no legal limitation on the amount of authorized revenue bonds that may be issued, but from a practical standpoint, the size of the issue must be limited to an amount where annual interest and principal payments are well within the revenues available for debt service on the bonds. Revenue bond covenants generally include coverage provisions which require that revenue from fees minus operating expenses be greater than debt service costs.

Revenue bonds can be issued under the Revenue Act of 1941 by any city or county. This would require approval from a majority of voters.

Certificates of Participation. Certificates of participation provide long-term financing through a lease agreement that does not require voter approval. The legislative body of the issuing agency is required to approve the lease arrangement by a resolution. The lessor may be a redevelopment agency, a non-profit organization, a joint powers authority, a for-profit corporation or other agency. The lessee is required to make payments typically from revenues derived from the operation of the leased facilities. In the case of drainage improvements, revenues could come from zone-wide rates and charges. The amount financed may include reserves and capitalized interest for the period that facilities will be under construction. One disadvantage with certificates of participation, as compared with revenue bonds, is that interest rates can be slightly higher than with revenue bonds due to the insecurity associated with the obligation to make lease payments.

Assessment District Financing. Financing by this method involves initiating assessment proceedings. Assessment proceedings are documents in "Assessment Acts" and "Bond Acts". An assessment act specifies a procedure for the formation of a district (boundaries), the ordering, and making of an acquisition or improvement, and the levy and confirmation of an assessment secured by liens on land. A bond act provides the procedure for issuance of bonds to represent liens resulting from proceedings taken under an assessment act. Procedural acts include the Municipal Improvements Acts of 1911 and 1913. The commonly used bond acts are the 1911 Act and the Improvement Bond Act of 1915. The procedure most prevalent currently is a combination of the 1913 Improvement Act with the 1915 Bond Act. Charges for debt service can be included as a special assessment on the annual property tax bill. The procedure necessary to establish an assessment district may vary depending on the acts under which it is established and the district size.

Financing for Improvements Benefiting New Development

Pay-as-you-go financing may be undesirable because it creates serious cash flow problems. Financing can overcome cash flow problems and make an earlier project start possible

Proposition 46 General Obligation Bonds. Proposition 46, passed by the state's voters in 1987, allows a general obligation bond issue for a limited area. If over ten property owners are included, a formal election must be held. The costs of the project are allocated to the properties by assessed valuation throughout the life of the bonds, so no administrative cost is incurred to reallocate each year as property splits and combinations occur. One disadvantage is that there would be considerable inequity. Assessed valuation is not related to the benefit received.

Mello-Roos Community Facilities Bonds. If a Mello-Roos district is formed, Mello-Roos bonds can be sold to finance the necessary improvements.

Marks-Roos Financing. The Marks-Roos Local Bond Pooling Act of 1985 has proven to be one of the more useful and flexible financing devices. It expands the types of projects and programs that can be financed by joint powers authorities, facilitates regional projects and pool financing, and may offer significant economies of scale and convenience. Marks-Roos bonds generally refer to bonds issued by a joint powers authority to make loans to or entering financing leases with or acquire bonds from two or more public entities or to a single entity for more than one project. Starting in 1989, public entities in California have been making increasing use of Marks-Roos bonds.

Advantages of Marks-Roos bonds are the ability to lock in current interest rates, and the cost savings of financing multiple projects with one bond issue versus separate stand alone bond issues for each project's financing. Disadvantages include higher interest rates if rates decrease after bonds are issued, greater legal and administrative complexity and risk, and additional costs resulting from the complexity and size of the bonds if proceeds are not entirely used to acquire obligations.

Financing Summary

For existing development, utility fees are a good method for generating revenue irrespective of whether pay-as-you-go or a debt financing method is used to pay for the cost of improvements. Increasing the City sales tax would generate income but approval by the voters is not as likely as with benefit assessments. The State Revolving Fund loans should be investigated further for a low-cost form of debt financing. In addition, revenue bonds or assessment district bonds may be appropriate for debt financing for improvements affecting existing developed areas.

For many individual on-site or semi-regional projects affecting newly developing areas, the most appropriate financing tool may be to require the developer to finance and construct the improvements. If the projects are more regional in nature, the most appropriate form of debt financing may be through Mello-Roos financing and perhaps Marks-Roos financing. Although it is not as common to do so, Mello-Roos could also be utilized for existing development. Existing land uses could be patterned into the tax formula so that developed properties with large runoff estimates would share a proportionately larger burden. Marks-Roos financing may be appropriate for joint venture projects and should be investigated further.